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No. 341

In the Supreme Court of the United States

October Term, 1931

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CORONADO OIL AND GAS COMPANY

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

BRIEF FOR THE PETITIONER

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No. 341

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

CORONADO OIL AND GAS COMPANY

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 24–52) is reported in 14 B. T. A. 1214. The opinion of the Court of Appeals of the District of Columbia (R. 96–102) is reported in 50 F. (2d) 998.

JURISDICTION

The judgment of the Court of Appeals was entered June 1, 1931. (R. 102.) The petition for the writ of certiorari was filed September 1, 1931,

and was granted October 26, 1931. (R. 103.) The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the United States may constitutionally impose a tax upon the net income of a private corporation derived from the sales of oil and gas produced under lease to it of lands owned by the State of Oklahoma and set apart for the maintenance of its common schools.

STATUTES INVOLVED

The statutes involved are set forth in the appendix, pp. 32–36, *infra*.

STATEMENT

By the Oklahoma Enabling Act Congress required, as a condition of admission into the Union, that the State should make provision in its constitution for a system of common schools, and for this purpose granted to the State certain lands, with the proviso that such as were valuable for minerals should not be sold but might be leased for periods of five years, the proceeds to be paid to the school fund. (R. 26.) Act of June 16, 1906, Sections 3, 7 and 8, c. 3335, 34 Stat. 267, 270, 272, 273, p. 33, *infra*. The State, by its constitution, provided for a common-school system, and pledged its faith to preserve the lands and moneys derived

from them as a "sacred trust" for the purposes for which the lands were granted. Constitution of Oklahoma, Article XI, Section 1, p. 34, *infra*. Legislative provision was made for leasing the lands containing gas and oil, and for the payment of the proceeds into the school fund. Oklahoma Compiled Statutes 1921, Sections 9415, 9417 and 9423, pp. 34–36, *infra*.

The State leased certain of these lands to respondent, an Oklahoma corporation, in January, 1914 (R. 27), renewing the lease (on somewhat different terms) in March, 1919 (R. 34, 59–95). Respondent agreed to deliver to the State under the first lease 50 per cent, and under the second lease 12½ per cent, of the gross production of oil and gas. (R. 30, 35.)

The Commissioner of Internal Revenue assessed taxes upon respondent's net income derived through the sale of its share of the oil and gas obtained from the leased lands during 1917, 1918, and 1919. (R. 25.) The Board of Tax Appeals sustained the action of the Commissioner. (R. 50; 14 B. T. A. 1214.) The Court of Appeals of the District of Columbia (Martin, C. J., dissenting) reversed the decision of the Board. (R. 96–102.)

SPECIFICATION OF ERROR

The Court of Appeals erred in holding that the United States was without power to tax the respondent's net income derived from the sale of the

respondent's share of oil and gas produced under lease of lands owned by the State of Oklahoma and set apart for the maintenance of its common schools.

SUMMARY OF ARGUMENT

1. The effect of the Federal tax, in the circumstances of this case, is too indirect and remote to interfere with any governmental function of the State. The tax involved is less direct and burdensome than the tax which this Court sustained in *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, or the tax sustained in *Willcuts* v. *Bunn*, 282 U. S. 216. The decision below is contrary to the principle of *Forbes* v. *Gracey*, 94 U. S. 762; *Gromer* v. *Standard Dredging Co.*, 224 U. S. 362; *Baltimore Shipbuilding Co.* v. *Baltimore*, 195 U. S. 375, and the cases following them. It is likewise contrary to the principle of the decisions of this Court in *United States Glue Co.* v. *Oak Creek*, 247 U. S. 321, *Shaffer* v. *Carter*, 252 U. S. 37; *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113.

2. The respondent is a private corporation engaged in business for its own profit. If for any purpose the respondent is an agency of the State, it is not exempt from the tax imposed upon income derived from the exercise of nongovernmental functions.

3. The decision of this Court in *Gillespie* v. *Oklahoma*, 257 U. S. 501, is not controlling here. That

decision rests on the peculiar relation of the United States to its Indian wards, and is in agreement with a recognized federal policy that any activity of the Federal Government in behalf of the Indians shall not be affected even very remotely by state taxation. Further, the decision is inapplicable here because the question as to whether there the lessee was a federal instrumentality was not argued or decided. It is also distinguishable because it dealt with the absolute immunity of activities and instrumentalities of the United States from State taxation, whereas the States enjoy no such immunity *unless* their activities are strictly governmental. *South Carolina* v. *United States,* 199 U. S. 437.

ARGUMENT

I

THE EFFECT OF THE FEDERAL INCOME TAX IN THE CIRCUMSTANCES OF THIS CASE IS TOO INDIRECT TO INTERFERE WITH ANY GOVERNMENTAL FUNCTION OF THE STATE

The effect of a tax upon the net income of respondent's business is too indirect and too remote to constitute an interference with any governmental function of the State. The tax is not laid upon the State. It is laid upon the respondent, a private corporation organized for private profit. See *Clallam County* v. *United States,* 263 U. S. 341, 345. The tax is not laid upon the petitioner's operations or its gross receipts from gas and oil

produced, nor is it laid upon the making of the lease; it is laid upon respondent's net income derived from all its business. The tax is not discriminatory; it is laid upon the net income of all corporations similarly situated throughout the United States. We believe that the decisions of this Court establish that such a tax is not an unconstitutional interference with the functions of a State.

It was pointed out by this Court in *Willcuts* v. *Bunn*, 282 U. S. 216, 231, that—

> It must be remembered that we are dealing, not with any express constitutional restriction, but only with an asserted implication.

The "asserted implication" has been re-examined in this Court in every new situation. In so far as taxes not directly laid upon a State or its instrumentalities are concerned, the limitation implied from the Constitution is not absolute, and must receive a practical construction which permits both the national government and the state governments to exercise their individual functions without serious impairment or interference. See *South Carolina* v. *United States*, 199 U. S. 437, 451–452. To extend the implied limitation too far is to defeat its very purpose by imposing unnecessary restrictions upon the essential sovereign power of taxation possessed by both the state and national governments. Distinctions, therefore, must be carefully drawn and their validity must be judged by their

practical effect.[1] In *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, it was said (pp. 523–524):

> * * * the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; * * *.

Our thesis was stated by this Court in *Railroad Co.* v. *Peniston*, 18 Wall. 5:

> It may, therefore, be considered as settled that no constitutional implications prohibit a State tax upon the property of an agent of the government merely because it is the property of such an agent (p. 33).
>
> It is, therefore, manifest that exemption of Federal agencies from State taxation is dependent, not upon the nature of the agents, or upon the mode of their constitution, or upon the fact that they are agents, but upon the effect of the tax; that is, upon the question whether the tax does in truth deprive them of power to serve the government as they were intended to serve it, or does hinder the efficient exercise of their power (p. 36).

The practical operation and effect of a tax has been constantly in the mind of this Court. In

[1] See *Powell*, "Indirect Encroachment on Federal Authority By the Taxing Powers of the States," 31 Harv. L. Rev. 321, 324, 327; 32 Harv. L. Rev. 902, 918, 926; *Cohen and Dayton*, "Federal Taxation of State Activities and State Taxation of Federal Activities," 34 Yale L. J. 807, 818, 821, 827; *Note*, 28 Ill. L. Rev. 707, 711; *Note*, 30 Col. L. Rev. 92, 103.

Plummer v. *Coler,* 178 U. S. 115, it was said (p. 136):

> * * * we still may be permitted to perceive that the mischief to our national credit, so feelingly deplored in the briefs, * * * would be inappreciable, and too remote and uncertain to justify us now in condemning the tax system of the State of New York.

Compare *St. Louis Southwestern Ry. Co.* v. *Arkansas,* 235 U. S. 350, 362; *Mountain Timber Co.* v. *Washington,* 243 U. S. 219, 237; *Crew Levick Co.* v. *Pennsylvania,* 245 U. S. 292, 294; *American Mfg. Co.* v. *St. Louis,* 250 U. S. 459, 463; *Shaffer* v. *Carter,* 252 U. S. 37, 55.

In *Heiner* v. *Colonial Trust Co.,* 275 U. S. 232, a tax was sustained which might have "some perceptible economic effect on the Indians." (P. 235.) In *Willcuts* v. *Bunn, supra,* this Court said (p. 230):

> No facts as to actual consequences are brought to our attention * * * showing that the inclusion in the federal tax of profits on sales of state and municipal bonds casts any appreciable burden on the States' borrowing power.

and at p. 231:

> * * * it must clearly appear that a substantial burden upon the borrowing power of the State would actually be imposed.

See also *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 162. The test of the directness of the effect of a

tax was also applied by this Court in *Thomas* v. *Gay*, 169 U. S. 264, 273, and *Wagoner* v. *Evans*, 170 U. S. 588, 591.

It is possible that future lessees of lands like those here may bid more for a lease if they can escape the burden of the income tax which rests upon competitors deriving materials from lands leased from private individuals, but we submit that such effect would not directly or substantially burden the State in maintaining its school system. As was said in *Group No. 1 Oil Corp.* v. *Bass*, 283 U. S. 279, a case like the instant case, except that decision there turned upon Texas decisions holding the lease in question was a sale of oil and gas in place—

> Property sold *or otherwise disposed of* by the government, either state or national, in order to raise revenue for government purposes, is in a broad sense a government instrumentality, with respect to which neither the property itself before sale, nor its sale by one government, may be taxed by the other. But it does not follow that the same property in the hands of the buyer, or his use or enjoyment of it, or the income he derives from it, is also tax immune. *New Brunswick* v. *United States*, 276 U. S. 547; *Forbes* v. *Gracey*, 94 U. S. 762; *Tucker* v. *Ferguson*, 22 Wall. 527; see *Weston* v. *Charleston*, 2 Pet. 449, 468; *Veazie Bank* v. *Fenno*, 8 Wall. 533, 547. Theoretically, any tax imposed on the buyer with respect to the purchased property may have some ef-

> fect on the price, and thus remotely and indirectly affect the selling government. We may assume that if the property is subject to tax after sale, the governmental seller will generally receive a less favorable price than if it were known in advance that the property in the hands of later owners, or even of the buyer alone, could not be taxed.
>
> But the remote and indirect effects upon the one government of such a nondiscriminatory tax by the other have never been considered adequate grounds for thus aiding the one at the expense of the taxing power of the other. See *Willcuts* v. *Bunn,* 282 U. S. 216, 231; *Educational Films Corp.* v. *Ward,* 282 U. S. 379; *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514, 523–524. * * * (P. 282.) (Italics ours.)

Yet the ultimate economic effect of the tax in the *Group No. 1* case is, of course, precisely the same as in the instant case.

The tax involved in this case is less direct and burdensome than the tax which this Court sustained in *Metcalf & Eddy* v. *Mitchell, supra.* Metcalf and Eddy made contracts with States and subdivisions of States, under which they performed engineering services in connection with sanitary projects, for which they were paid from public funds. Like the respondent in the present case they contended that they were an instrumentality of the State, but this Court held otherwise, and said (pp. 522–523, 524–525):

> * * * it is apparent that not every person who uses his property or derives a profit, in his dealings with the government, may clothe himself with immunity from taxation on the theory that either he or his property is an instrumentality of government * * *.
>
> * * * * *
>
> The tax is imposed without discrimination upon income whether derived from services rendered to the state or services rendered to private individuals. In such a situation it can not be said that the tax is imposed upon an agency of government in any technical sense, and the tax itself can not be deemed to be an interference with government, or an impairment of the efficiency of its agencies in any substantial way.

The same result was reached in *Lucas* v. *Howard,* 280 U. S. 526, and *Lucas* v. *Reed,* 281 U. S. 699; yet in each of these cases the income taxed was received directly from the State, while in the present case the income taxed is derived from private business transactions with third persons.

If Metcalf and Eddy had been employed to manage the production and sale of the oil on these lands for the State of Oklahoma, compensation received for such services would under the decision in their case certainly have been taxable income. The *Metcalf & Eddy* case can not be distinguished upon the theory that the lessee here is a governmental agency in the performance of governmental functions. It can not be said that construction and maintenance by States of municipal water

and sewerage works are less governmental than oil and gas development by private corporations.

The principle applicable to the present case is that of *Forbes* v. *Gracey*, 94 U. S. 762. There this Court sustained a tax levied by a State upon ore extracted from mining lands. The taxpayer held a mining claim from the United States, but title to the lands on which the mines were situated was in the United States. The decision was that ore severed from the mine became personal property and that the rights of the United States were not affected either by tax on the ore itself or by a provision of the taxing law whereby the tax became a lien on mining claims. It was pointed out that mining claims were property which could be sold, transferred, mortgaged, and inherited without infringing the title of the United States, and that the United States would not be at all affected by the sale of the mining claim to enforce the tax lien. The analogy is obvious. In the present case the oil and gas from the sale of which income is derived is the personal property of the lessee once it has been produced and the State can have no interest in the lessee's profit derived from its sale. And to the argument that the State has an interest in developing oil and gas lands, the answer is that the interest of the United States in developing the mining lands in the Western States is quite as important as the interest of the State of Oklahoma in the present case. If, therefore, the State may tax the product of land, title to which is in the Federal Govern-

ment, *a fortiori* the Federal Government may tax net income realized from the sale of the product of land to which the State has title.

The cases are numerous where private gains more immediately connected with the business of Government have been held by this Court to be within reach of the taxing power. In *Gromer* v. *Standard Dredging Co.*, 224 U. S. 362, this Court held that Porto Rico might tax machinery and boats engaged in dredging work in San Juan Harbor in pursuance of a contract with the United States. In *Baltimore Shipbuilding Co.* v. *Baltimore*, 195 U. S. 375, it was held that a State might tax the interest of a company owning a dry dock in land conveyed to it by the United States, notwithstanding provisions in the instrument of conveyance that upon certain contingencies the property should revert to the United States and that the United States had a continuing interest to use the dry dock to serve its purposes.

In *South Carolina* v. *United States, supra*, it was held that the Federal Government might exact a license tax from State agencies operating liquor dispensaries established by the State of South Carolina.

In *Alward* v. *Johnson*, 282 U. S. 509, it was held that a State might levy a gross receipts tax upon the franchises and property of a bus line, although three-fourths of its revenues were earned by carrying the United States mail. In *Elder* v. *Wood*, 208

U. S. 226, it was held that a State might tax a mining claim held under the United States, although title to the land remained in the United States. In *New Brunswick et al.* v. *United States,* 276 U. S. 547, it was held that land, title to which was in the United States Housing Corporation, might be taxed by the city to persons under agreement to purchase such land.

In *Shaw* v. *Oil Corporation,* 276 U. S. 575, it was held that the State of Oklahoma might impose a tax on the gross value of oil and gas produced under a lease of lands which were purchased for a full-blood Creek Indian, by his guardian, with royalties received from a lease of his restricted lands. The lands in question were inalienable by him without the consent of the Secretary of the Interior. In *Choctaw, O. & G. Railroad Company* v. *Mackey,* 256 U. S. 531, it was held that an Oklahoma municipality might levy a special assessment for street improvements against part of the right of way and station ground of a lessee railroad company whose lessor was a corporation to which Congress had granted the right to build a railroad in Indian Territory, with a branch line to coal mines leased from the Choctaw Nation. In *Thomas* v. *Gay, supra,* it was held that an Oklahoma county might tax cattle grazing on Indian lands under certain leases for grazing purposes made by the Osage tribal government as lessor, subject to the ratification of the Commissioner of Indian Affairs and of the Secretary of the Interior.

In *Thomson* v. *Pacific Railroad Co.*, 9 Wall. 579, it was held that a State might tax property of a railroad corporation which had been the recipient of benefits by way of subsidy from the United States, and which was bound to perform certain services for the United States. In *Railroad Company* v. *Peniston, supra,* it was held that Lincoln County, Nebraska, could tax the Union Pacific Railroad Company on its property in the county, although the railroad company was a Federal corporation chartered for the purposes, among others, of carrying the mails, of transporting troops and supplies, and of performing other services for the United States. See also *Central Pacific Railroad Company* v. *California,* 162 U. S. 91.

In *Willcuts* v. *Bunn, supra,* it was decided that the United States could impose a tax upon a profit derived from a sale by a private owner of municipal and state bonds. In that case this Court said:

> The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds (p. 227).

Similarly, we submit that the sale of the oil and gas by the respondent to third persons was a transaction distinct from the lease made between the respondent and the State, and that the profits from

such sales are not in the same category of income as the rental paid by the respondent to the State.

See also *Educational Films Corp.* v. *Ward,* 282 U. S. 379, in which this Court held that a state tax imposed upon the privilege of doing business was not sufficiently burdensome on an instrumentality of the Federal Government to be invalid, even though the measure of the tax included the income from copyrights.

It should be borne in mind, in determining whether the present tax is a burden upon the State, that the tax is imposed upon net income and not upon gross receipts. This Court has frequently pointed out that a tax on net income does not constitute a direct burden upon the subject from which the income is derived. Thus, in *Peck & Co.* v. *Lowe,* 247 U. S. 165, and in *Barclay & Co.* v. *Edwards,* 267 U. S. 442, it was held that a net income tax may constitutionally be imposed upon the income derived from the business of exporting goods from the United States, although Clause 5 of Section 9 of Article I of the Constitution provides that "No Tax or Duty shall be laid on Articles exported from any State." And it has several times been held that a State may validly lay a net income tax upon income derived from interstate commerce. *United States Glue Co.* v. *Oak Creek,* 247 U. S. 321; *Shaffer* v. *Carter,* 252 U. S. 37; *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113.

The principle involved in the *Metcalf & Eddy* case has been applied by this Court and other courts

in other situations. Thus, in *Veazie Bank* v. *Fenno*, 8 Wall. 533, this Court upheld a tax on notes issued by a bank operating under a state franchise. In *National Bank* v. *United States*, 101 U. S. 1, a tax on notes issued by a municipality and used as money was upheld. In *Manhattan Co.* v. *Blake*, 148 U. S. 412, it was held that a Federal tax on the average deposits of a bank was not unconstitutional by reason of the fact that there were included moneys deposited by the treasurer of the State of New York. In *Snyder* v. *Bettman*, 190 U. S. 249, a succession tax on the transfer of property by will to a municipality was upheld. And in *James A. Sackley Co.* v. *United States*, 65 C. Cls. 304, it was held that the Federal income tax might be imposed upon income derived from a contract to pave the streets of a municipality.

See also *Henderson Bridge Co.* v. *Henderson City*, 173 U. S. 592 (tax on interstate bridge erected by consent of Congress); *Thompson* v. *Kentucky*, 209 U. S. 340 (tax on whiskey in government warehouse); *Wagoner* v. *Evans*, *supra* (tax on cattle grazing on leased Indian lands); *Montana Catholic Missions* v. *Missoula County*, 200 U. S. 118 (tax on cattle customarily destined for Indian charities); *United States* v. *Ransom*, 263 U. S. 691 (tax on land bought for an Indian with oil-lease royalties); *Swarts* v. *Hammer*, 194 U. S. 441 (tax on property held by a trustee under Federal Bankruptcy Act).

II

IF FOR ANY PURPOSE THE RESPONDENT IS AN AGENCY OF THE STATE IT IS NOT EXEMPT FROM THE TAX IMPOSED UPON INCOME DERIVED FROM THE EXERCISE OF NON-GOVERNMENTAL FUNCTIONS

As lessee of state lands the respondent is engaged in producing oil and gas for the State and for itself. In so far as its share of the product is concerned, it is engaged, like any other producer, in conducting a business enterprise for private profit.[2]

In upholding the immunity from state taxation of a corporation created and exclusively employed as an instrumentality of the United States, this Court, in *Clallam County* v. *United States*, *supra*, said (p. 345):

> This is not like the case of a corporation having its own purposes as well as those of the United States and interested in profit on its own account.

The fact that the State of Oklahoma is entitled to a share of the product as a royalty under the lease does not convert the respondent's business of selling its own share of the product for profit into the performance of a governmental function. No doubt the mutual advantages of production are the considerations for the lease, and the relationship between the respondent and the State is substan-

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[2] See *Cohen and Dayton*, "Federal Taxation of State Activities and State Taxation of Federal Activities," 34 Yale Law Journal, 807, 821; *Note*, 23 Illinois Law Review, 707, 711.

tially contractual. But such relationships do not convert private concerns into governmental agencies and exempt them from the burden of general taxation. This Court in *Fidelity & Deposit Co.* v. *Pennsylvania*, 240 U. S. 319, said (p. 323):

> But mere contracts between private corporations and the United States do not necessarily render the former essential governmental agencies and confer freedom from state control. *Baltimore Shipbuilding Co.* v. *Baltimore*, 195 U. S. 375.

See also *Hall* v. *Wisconsin*, 103 U. S. 5, 10; *Baltimore Shipbuilding Co.* v. *Baltimore*, *supra*, 382; and *Metcalf & Eddy* v. *Mitchell*, *supra*, at pp. 524–525.

Another consideration was raised in *Montana Catholic Missions* v. *Missoula County*, 200 U. S. 118, where this Court said (p. 130):

> Congress has not constituted this corporation an agency of its own for the purpose of discharging any duties which the Government may owe to the Indians.

In *South Carolina* v. *United States*, 199 U. S. 437, it was held that an agent of the State of South Carolina, carrying on the business of selling liquor under state authority, was liable to pay the internal revenue tax imposed by the Federal Government. The rule in that case is that the exemption of state agencies and instrumentalities is limited to those of strictly governmental character, and does not extend to those used by the State in carrying on

business of a private character. (*Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 157.)

We submit that the respondent's business of selling its share of oil and gas produced is less governmental in character than the business involved in the *South Carolina* case of dispensing liquor.

In *Salt Lake City* v. *Hollister*, 118 U. S. 256, it was held that a city engaged in the business of distilling spirits was subject to the internal revenue laws of the United States, although the profits were paid into the city treasury. The economic effect of the tax sustained by this Court in *City of Philadelphia* v. *The Collector*, 5 Wall. 720, was imposed upon a gas plant which was in substance owned and in fact operated by the city of Philadelphia. See also *United States Bank* v. *Planters' Bank*, 9 Wheat. 904; *State of North Dakota* v. *Olson*, 33 F. (2d) 848 (C. C. A. 8th), dismissed for lack of jurisdiction, 280 U. S. 528; *School District of Fort Smith* v. *Howe*, 62 Ark. 481.

If the State itself were to enter the business of producing and selling oil and gas its agent could be taxed under the doctrine of the *South Carolina* case, the *Hollister* case and the *Olson* case. It would be liable for its torts in connection with that business because the production of oil and gas is not a governmental function. See *Salt Lake City* v. *Hollister*, *supra*, 261; *City of Philadelphia* v. *Gavagnin*, 62 Fed. 617 (C. C. A. 3d); *Duggan* v. *Peabody*, 187 Mass. 349; *Oliver* v. *Worcester*, 102

Mass. 489; *Hoppe* v. *City of Winona*, 113 Minn. 252.

It is difficult to see why the income of a private corporation should be exempt from taxation because it is the lessee of the state government when a tax laid on the same activity of the state government would be valid. We submit that the use made of the funds, which chances to have been designated by the Enabling Act, does not override the doctrine which would be applicable if the State itself had gone into the oil business.

III

GILLESPIE v. OKLAHOMA, 257 U. S. 501, IS NOT CONTROLLING

In the opinion of the court below, after reviewing the decisions of this Court cited in support of the contention that the tax is not imposed upon the lands or upon the oil or gas or the proceeds of the same, which the State is entitled to receive, but is confined solely to that portion of the value of the gas and oil produced which appellant as a private corporation is entitled to have and use for its own account, and that therefore the tax does not interfere with or impose a burden upon the State, the court said:

> * * * there is much strength and force in this argument, and, if the question were not, as we think, foreclosed, we are inclined to think we might feel impelled to adopt the view; but, as we see it, the Supreme Court has laid down the rule in *Gillespie* v. *Okla-*

homa, 257 U. S. 501, and *Jaybird Mining Co.* v. *Weir,* 271 U. S. 609, by which we are controlled.

It must at once be conceded that if the decision in the *Gillespie case* is extended in its application to facts differing only slightly, but still differing, from the facts involved in that case, the court below had much reason for believing its decision to be controlled by the decision of this Court in the *Gillespie case.* That decision was, however, predicated upon the peculiar and anomalous relationship existing between the United States and its Indian wards, and particularly upon the duties and obligations of the Federal Government as trustee for the Indians of restricted Indian lands. The anomalous character of these relationships and duties was emphasized by this Court in *Shaw* v. *Oil Corporation,* 276 U. S. 575, where lands purchased for an Indian were held to be subject to state taxation. There it was said (p. 578):

> What governmental instrumentalities will be held free from state taxation, though Congress has not expressly so provided, cannot be determined apart from the purpose and character of the legislation creating them. *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514. The end sought and the mode of attaining it adopted by Congress in the legislation providing for the welfare of the Indians by setting apart, by allotment or otherwise, tribal lands or the public domain, restricted for their benefit, led to the conclusion that those

> lands and the uses of them were so intimately connected with the performance of governmental functions as clearly to require independence of all state control so complete that nothing short of an express declaration by Congress would have subjected them to state taxation.

Gillespie v. *Oklahoma, supra,* pushed this exemption to the limit by exempting from state taxation upon incomes generally income derived by a lessee of unrestricted Indian lands from the sale of oil and gas produced under the lease. This was a step beyond the later decision of this Court in *Jaybird Mining Co.* v. *Weir,* 271 U. S. 609, where the tax sustained was imposed upon ores in mass at the mine before sale. This was a step beyond the prior decisions of this Court in *Choctaw, Oklahoma & Gulf R. R. Co.* v. *Harrison,* 235 U. S. 292; *Indian Territory Illuminating Oil Co.* v. *Oklahoma,* 240 U. S. 522; *Howard* v. *Gypsy Oil Co.,* 247 U. S. 503, and *Large Oil Co.* v. *Howard,* 248 U. S. 549, where it was held that lessees of restricted Indian lands could not be subjected to state taxation based upon gross production from the leased lands. In *Jaybird Mining Co.* v. *Weir, supra,* this Court was not required to go beyond the principle of the decisions which antedated the decision in the *Gillespie case,* for there the tax involved was assessed on the ores in mass at the mine before sale, and was not a tax imposed generally upon all income.

For the first time, this Court is now asked to extend the decision in the *Gillespie case* so as to exempt from the Federal income tax the income derived by a lessee of state lands from the sale of its share of oil and gas produced under the lease.

If the principle underlying the decision in the *Gillespie case* were one of general and universal application, to be extended to all instrumentalities of government regardless of the purposes of their creation or the functions for the performance of which they are created, the simple statement that the *Gillespie case* is controlling might well be accepted without further thought. But this field of the law, as the decisions disclose, from the time of *McCulloch* v. *Maryland,* 4 Wheat. 316, to the present day, is one in which the rules are not absolute, and in the delicate balance of conflicting limitations upon governmental powers arising only by implication each case must be determined by the very considerations referred to by this Court in *Shaw* v. *Oil Corporation, supra,* namely, the purpose and character of the legislation creating the instrumentality of government, and, it goes without saying, the particular governmental functions which it is created to perform.

The differences in purpose and function of the lease in this case and the lease in the *Gillespie case* are plainly to be found in the peculiar and anomalous character of lands originally granted to the Indian Tribes as independent nations, and in the duties which the Federal Government has assumed

toward these peoples, not only as wards of the Nation but as the beneficiaries of such lands held in trust for them by the Nation. That the decisions of this Court dealing with such lands have been influenced by such considerations is entirely clear, and is emphasized by the quotation from the opinion of this Court in *Shaw* v. *Oil Corporation, supra.* That such considerations influenced the decision of this Court in the *Gillespie case* is emphasized by the fact that that decision stands alone within this field of the law, and, if such considerations be ignored, is in apparent conflict with numerous decisions which we have cited under Point I, *supra.*[3]

As Marshall, C. J., said in *Cherokee Nation* v. *State of Georgia,* 5 Pet. 1, 16, "The condition of the Indians in relation to the United States is, perhaps, unlike that of any other two people in existence."

The relationship between the United States and its Indian wards involved in the *Gillespie case,* and other cases dealing with Indian lands, presented

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[3] It is generally recognized that the Indian cases stand by themselves as the expression of a policy. In a note in 23 Illinois Law Review, 707, referring to the Indian cases, the writer says (p. 712):

"The results reached in several of these cases are quite out of line with prior decisions of the Court, and must be explained as due to anxiety to protect to the fullest possible extent the development of Indian properties for the benefit of these wards of the Nation. It is unsafe to use such decisions as establishing principles of general application."

A note in 30 Columbia Law Review, 92, referring to the decision in the *Kansas Indians,* 5 Wall. 737, which holds that

a unique situation because of the dependence of the Indians on the Federal Government and the promises of the latter to protect their property. The obligations to these tribes were assumed pursuant to constitutional authority, and the Federal Government became obligated to secure the greatest possible benefit from the mineral-bearing lands which it held and administered in trust for them. This it undertook to do by leasing these lands, and in making such leases it was directly engaged in the performance of a sovereign duty which it had expressly assumed under authority of the Constitution. See *Choctaw Gulf R. R.* v. *Harrison, supra,* p. 298, and *Indian Oil Co.* v. *Oklahoma, supra,* p. 530. And thus it was held that to tax the lands at all was "to tax an instrumentality employed by the United States for the benefit and control of this dependent race." *United States.* v. *Rickert,* 188 U. S. 432.

And so we believe that we are justified in contending that the court below fell into error in con-

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a State property tax could not be levied on Indian lands, says (note 16, p. 93):

"It must be noted, however, that the anomalous position which the Indians occupy in our law weakens the probative value of such decisions in other situations involving federal instrumentalities."

A note in 42 Harvard Law Review, 128, refers to the *Jaybird* case in this language:

"This class of cases is distinguishable, however, as resulting from a strong governmental policy of protecting Indians in their lease allotments, rather than a genuine attempt to protect a federal instrumentality." (Citing *Shaw* v. *Gibson-Zahniser Oil Corporation, supra.*)

cluding that its decision was controlled by the decision of this Court in the *Gillespie case*, because of the essential differences in the governmental functions involved in this case. It should also be noted that in the *Gillespie case* the State conceded that the lessee was a governmental agency of the United States.[4] It was said in that case (p. 504):

> It is agreed that the lessee was an instrumentality used by the United States in carrying out duties to the Indians that it had assumed, and that the only question in the case is whether he is liable to this kind of tax.

No such concession is made by the Government in this case. Indeed, we cannot see any difference in substance between the lessee in this case and the lessee in the *Group No. 1 Oil Case, supra*, and

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[4] From an examination of the record in that case it appears that the respondent State made no argument as to the capacity in which the lessee received his net income. The appellant lessee presented as the first point in his brief in this Court that he was an instrumentality of the Federal Government (*Gillespie*, Pet. Br. 27–31) under the rule in *Choctaw, etc., R. Co.* v. *Harrison*, 235 U. S. 292, 298; *Indian Oil Co.* v. *Oklahoma*, 240 U. S. 522, 529; *Howard* v. *Gypsy Oil Co.*, 247 U. S. 504 (per curiam); *Large Oil Co.* v. *Howard*, 248 U. S. 549 (per curiam); *Large Oil Co.* v. *Howard*, 63 Okla. 143; *Re Tax of Wolverine Oil Co.*, 53 Okla. 24. The brief of the respondent State did not present any discussion of this phase of the case, unless that is implicit in its statement (Resp. Br. 4) that the sole question was whether the tax was "an unlawful burden upon a federal agency or instrumentality."

Further, in the first opinion of the Supreme Court of Oklahoma (delivered December 14, 1920, and abandoned entirely

we venture to urge that the delicate balance of implied limitations upon the exercise of governmental power should not be disturbed by distinctions drawn between the legal conception of a lease which is a sale of oil and gas in place and a lease under which the traditional relationship between landlord and tenant exists. The agreement of counsel in the *Gillespie case* that the lessee was an instrumentality of the Federal Government apparently made it unnecessary for this Court to consider the activities of the lessee in order to determine whether, in selling its share of the oil produced and endeavoring to derive a profit therefrom, it was in

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by the decision of April 5, 1921, 81 Okla. 103, which was the decison this Court reviewed), it is said (*Gillespie*, R. 69–70):

"* * * The parties agree that the Attorney General correctly states the question of law at issue in his brief, as follows:

"The only question presented other than the one of penalties is whether or not the state is prevented from collecting income tax from leases on Indian lands under the supervision and approval of the Secretary of the Interior upon the same considerations which led the Court to deny that right to the State in what is known as the gross production tax cases, to-wit: *Choctaw & Gulf R. R. Co.* v. *Harrison*, 235 U. S. 292, * * *; *Indian Oil Co.* v. *Oklahoma*, 240 U. S. 522 * * *; *Howard* v. *Gypsy Oil Co.*, 247 U. S. 504 * * *; *Large Oil Co.* v. *Howard*, 248 U. S. 549 * * *.

"As it is agreed between counsel that under the cases just cited it is settled law [that leases are under federal protection and] that the lessees are Federal Agencies in whose hands the leases can not be taxed either directly or vicariously, it will not be necessary to notice any of the aspects of the case at bar except those which the Attorney General contends distinguish it from the cases cited."

fact performing a governmental function in the exercise of a governmental agency. Here, we contend that in selling its own share of the product from the leased land the respondent was engaged in the performance of no governmental function, and was not exercising any agency of the State.

There is a further distinction which may possibly be drawn between the activities of the United States and those of the States. Because of the fundamental supremacy of the Constitution, law, and treaties of the United States, constitutional powers delegated to persons or corporations by the Federal Government are necessarily beyond the reach of any power of the States, including the power of taxation. *California v. Pacific R. R. Co.*, 127 U. S. 1, 41. Thus, it was said in the *Jaybird case, supra* (p. 613): "The federal government in all its activities is independent of state control." And in the *Gillespie case, supra*, the decision of this Court was grounded upon the absolute immunity from taxation of all instrumentalities of the United States, it being said in the opinion (p. 505): "The rule as to instrumentalities of the United States * * * is absolute in form * * *." The activities of a State, however, enjoy no such absolute immunity from Federal taxation, the validity of such taxation, as we have seen, being dependent upon the nature of the activities in which the State, through its agencies, may be engaged. If these

activities are not of a strictly governmental character, they may be subjected to Federal taxation. *South Carolina* v. *United States, supra; Flint* v. *Stone Tracing Co., supra* (p. 157); cf. *McCulloch* v. *Maryland, supra.* See also *United States Bank* v. *Planters' Bank*, 9 Wheaton, 904, 907; *Hall* v. *Wisconsin, supra* (p. 11); *Van Brocklin* v. *State of Tennessee*, 117 U. S. 151 (p. 158); *State of Alabama* v. *United States* (Ct. Cls.), 38 F. (2d) 897, 902; dismissed for want of jurisdiction, 282 U. S. 502.

In this case we submit that the sale of oil and gas from which income was derived by the lessee was not an activity of a strictly governmental character, and if such business had been conducted directly, through agencies of the State, it would nevertheless have been subject to Federal taxation under the decision of this Court in the *South Carolina case, supra.* This was strictly private business, conducted by a private corporation for its own profit. To tax such profits does not impose a burden upon the strictly governmental functions of the State. Whenever a State engages in private business that business is not withdrawn from the taxing power of the nation. *South Carolina* v. *United States, supra,* p. 463.

CONCLUSION

The decision of the court below should be reversed.

Respectfully submitted.

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DECEMBER, 1931.

APPENDIX

Revenue Act of 1916, c. 463, 39 Stat. 756:

> SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax * * *.
>
> SEC. 11. (b) There shall not be taxed under this title any income derived * * * from the exercise of any essential governmental function accruing to any State * * *.

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065, 1077:

> SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, * * *.
>
> SEC. 213. That for the purposes of this title * * * the term "gross income"—
>
> (a) Includes gains, profits, and income derived * * * from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for

gain or profit, or gains or profits and income derived from any source whatever. * * *

Act of June 16, 1906, c. 3335, 34 Stat. 267, 270, 272, 273:

SEC. 3. Fifth. That provisions shall be made for the establishment and maintenance of a system of public schools, which shall be open to all the children of said State and free from sectarian control; * * *.

SEC. 7. That upon the admission of the State into the Union sections numbered sixteen and thirty-six, in every township in Oklahoma Territory, and all indemnity lands heretofore selected in lieu thereof, are hereby granted to the State for the use and benefit of the common schools: * * *.

There is hereby appropriated, out of any money in the Treasury not otherwise appropriated, the sum of five million dollars for the use and benefit of the common schools of said State in lieu of sections sixteen and thirty-six, and other lands of the Indian Territory. * * *

SEC. 8. * * *

Where any part of the lands granted by this Act to the State of Oklahoma are valuable for minerals, which terms shall also include gas and oil, such lands shall not be sold by the said State prior to January first, nineteen hundred and fifteen; but the same may be leased for periods not exceeding five years by the State officers duly authorized for that purpose, such leasing to be made by public competition after not less than thirty days' advertisement in the manner to be prescribed by law; and all such leasing shall be done under sealed bids and awarded to the highest responsible bidder. The leasing shall require and the advertisement shall

specify in each case a fixed royalty to be paid by the successful bidder, in addition to any bonus offered for the lease, and all proceeds from leases shall be covered into the fund to which they shall properly belong, and no transfer or assignment of any lease shall be valid or confer any right in the assignee without the consent of the proper State authorities in writing: * * *.

Constitution of Oklahoma, Article XI:

SECTION 1. *State Accepts All Grants.*—The State hereby accepts all grants of land and donations of money made by the United States under the provisions of the Enabling Act, and any other Acts of Congress, for the uses and purposes and upon the conditions, and under the limitations for which the same are granted or donated; and the faith of the State is hereby pledged to preserve such lands and moneys and all moneys derived from the sale of any of said lands as a sacred trust, and to keep the same for the uses and purposes for which they were granted or donated.

Oklahoma Compiled Statutes of 1921:

SEC. 9415. *Commissioners to segregate public land containing oil and gas.*—When any tract of the school or other public lands, granted to the State of Oklahoma under the act of congress known as the "Enabling Act" is known by the commissioners of the land office of the State to contain oil or gas, or where such lands are, by said commissioners, deemed valuable for oil and gas purposes, such commissioners shall enter of record in their office their finding, declaring that such oil or gas character exists, and further declaring that the oil and the gas de-

posits are segregated from the surface use and interest therein, and such segregation of such deposits shall conclusively withhold the same from sale, lease, or other alienation, except as provided in this article.

SEC. 9417. *Lease of oil and gas interest.*—The oil and gas interest described in this article in such lands may be leased by the commissioners of the land office for oil and gas purposes to the same extent and in the same manner as a private owner of lands in fee could, in his own right, execute a grant thereto, subject, however, to the following limitations:

First. For a period not exceeding five years, with suitable provisions for preference right to release for a second term of five years at its expiration, at the maximum rate of rentals, royalties, and bonuses that may be obtained therefor, at the time of such renewal.

Second. Upon due advertisement and public notice of not less than thirty days, in such manner as the commissioners may, by rule, prescribe.

Third. Such leasing shall be done under public bids and awarded to the highest responsible bidder: Provided, that the commissioners of the land office shall have power to reject any and all bids.

SEC. 9423. *Disposition of funds from oil and gas lands.*—The proceeds derived in bonuses and royalties and from other inducements and considerations for the execution and operation of the oil and gas leases in this article provided, shall be carried in the several funds, for the use and benefit of which such lands were granted by the United States to the State of Oklahoma, and to the territory now comprising the area embraced

within the said State, under the provisions of the enabling act, and any and all other acts of Congress, for the uses and purposes, and upon the conditions, and under the limitations for which the same were granted; and the money resulting from such lease and from the operation thereof shall be handled, disposed of, and used in like manner as the other moneys belonging to said several funds under the laws of this State.

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